

REBUTTAL TESTIMONY OF TIMOTHY DOMINAK

I. Introduction

Q. Please state your name and business address.

A. Timothy Dominak, 2000 West Ameritech Center Drive, Hoffman Estates, IL 60196.

Q. Are you the same Timothy Dominak who previously submitted Ameritech Illinois Exhibit 7.0, Schedules 1, 2, and 3 in this docket?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to respond to the testimony of certain witnesses for Staff and the Government and Consumer Intervenors (“GCI”) in which they propose adjustments to the 1999 operating income statement and December 31, 1999 statement of Net Original Cost of Property, as shown in Schedules 1 and 2, respectively, of my Direct Testimony, Exhibit 7.0. Staff and GCI propose these adjustments as part of their analyses of the Company’s intrastate “revenue requirement”.

Q. Have you updated your Schedule to reflect more current information?

A. Yes. Schedules 1 and 2 of Ameritech Illinois Exhibit 7.0 should be adjusted to reflect known and measurable changes which became known after that Exhibit was filed. These adjustments, which are discussed in Section II of my Rebuttal Testimony, are necessary to present a more accurate picture of Ameritech Illinois' financial information for 1999. In addition, the Company agrees that certain of the adjustments proposed by Staff and GCI are appropriate and should be reflected in the Company's financial results for 1999. These adjustments are discussed in Section III of this Rebuttal Testimony. The adjustments discussed in Sections II and III are reflected in the revised statements of operating income and net original cost of property contained in Schedules 1 and 2, respectively, attached to this Rebuttal Testimony

II. KNOWN CHANGES TO EXHIBIT 7.0, SCHEDULES 1 AND 2.

Q. Please discuss the adjustments for known changes which you have made to Exhibit 7.0 Schedules 1 and 2.

A. I have made five such adjustments, which I discuss below.

1. Ameritech Services 1999 Settlement Gains

As shown in Exhibit 7.1, Schedule 1, Column D, I have updated the adjustment for settlement gains and curtailment losses resulting from the payment of lump-sum distributions from the pension plan due to abnormal force losses, to include the settlement gains and curtailment losses that were charged from Ameritech Services, Inc. to Ameritech Illinois in 1999. Ameritech Illinois holds a one-third equity interest in Ameritech Services, which provides centralized services on behalf of the five Ameritech Operating Companies. Accordingly, Ameritech Illinois received 31.88% of the Ameritech Services pension settlement gains and curtailment losses. For the reasons discussed in Section III below, in response to Staff and GCI testimony, it is not appropriate to recognize pension settlement gains and curtailment losses as current period gains for purposes of defining a normalized year of financial data. Such gains and losses represent an accelerated recognition of gains that occurred in previous periods but were deferred in accordance with FAS 87 accounting rules. This adjustment results in a decrease in the intrastate balance available for return of \$11,183,000.

2. Application of Non-regulated Factor to Prior Period Adjustments

As shown in Exhibit 7.1, Schedule 3, I have updated the non-regulated factor used to compute the Corporate Operations Expense Prior Period adjustment of \$117,902,000 (originally filed on Ameritech Illinois Exhibit 7.0, Schedule 1). The adjustments were booked to account 6728, Other General and Administrative Expense. However, the non-regulated

factor of the entire Corporate Operations Expense grouping .1303 (all 67XX accounts) was used to determine the non-regulated amount for Column C of Ameritech Illinois Exhibit 7.0, Schedule 1. The non-regulated factor applicable to account 6728 is .0463, resulting in a decrease of non-regulated expenses of \$9,904,000 and a decrease in the intrastate balance available for return of \$5,975,000.

3. Publishing – Listing Services

As indicated in the response to Staff data request MHE-004, Ameritech Illinois Exhibit 7, Schedule 1, Column (H) was understated. The amount for Listing Services Revenue of \$3,678,791 in 1999 was inadvertently omitted. This results in a decrease in the intrastate balance available for return of \$2,220,000 which has been reflected on Exhibit 7.1, Schedule 1, Column C.

4. Depreciation

Ameritech Illinois Exhibit 7, Schedule 1, Column (M), Depreciation and Amortization and Exhibit 7, Schedule 2, Column (E), Depreciation Reserve were overstated for Analog Switching, Account 2211, General Purpose Computers, Account 2124, and Circuit DDS, Account 2232.11. The Company inadvertently reported depreciation expense when the depreciation reserve levels had attained 100 percent. The intrastate depreciation expense and depreciation reserve were overstated by \$ 85.646 M,

\$ 8.560 M, and \$ 7.450 M, respectively. This adjustment results in an increase in the intrastate balance available for return of \$ 61.333 M and an increase to the intrastate net original cost of the same amount, which has been reflected on Exhibit 7.1, Schedule 1, Column E and Schedule 2, Column C.

5. Additional Tariff Filings

I have reflected the annual impact of tariff changes approved by this Commission since June of 2000 which were not included in my Exhibit 7.0, Schedule 1.

**III. ADJUSTMENTS WHICH THE COMPANY BELIEVES ARE
APPROPRIATE FOR REGULATORY FINANCIAL REPORTING
PURPOSES**

Q. Are there any adjustments proposed by Staff and GCI in this case with which the Company agrees are appropriate?

A. Yes, the Company agrees that certain proposed adjustments impacting the balance available for return and net original cost of property for the following items are appropriate:

- (1) Software Capitalization (SOP 98-1)
- (2) Income Tax Calculation

- (3) Sports Team Sponsorship
- (4) Merger Planning and Implementation Costs
- (5) AFUDC
- (6) Uncollectibles
- (7) Materials and Supplies

Q. GCI witness Smith proposed an adjustment to reflect the adoption of SOP 98-1 in Schedule E-10 of GCI Exhibit 6.1. Please discuss this adjustment.

A. I agree with the premise of Mr. Smith's proposal to capitalize software in accordance with SOP 98-1. However, the Company's original submission in Exhibit 7.0, Schedule 2 already includes the capitalized SOP 98-1 adjustment in both the Plant in Service and Amortization Reserve lines. The Total Operating Expenses also includes the software expense and, therefore, are reduced on my Exhibit 7.1, Schedule 1, Column H. This reduction increases the intrastate balance available for return by \$796,000.

Q. Mr. Smith proposes an adjustment to Ameritech Illinois Exhibit 7.0, Schedule 1 for the calculation of federal income taxes. Please explain this adjustment.

A. The Company has indicated in the response to data request DLH-005 Supplement that there was an inadvertent omission in the calculation of federal income tax on Ameritech Illinois Exhibit 7.0, Schedule 1. The federal income tax has been recomputed, which results in an adjustment of \$2,189,000 on Exhibit 7.1, Schedule 3, Column B.

Q.

R. Q. Do you accept the the proposed adjustment by Mr. Smith for sports team sponsorship as reflected on GCI Exhibit 6.1, Schedule E-7?

A. While Ameritech Illinois believes that its sports teams sponsorship is an appropriate expenditure of company funds, it is willing to accept the proposed adjustment of \$96,000 to intrastate Customer Operations Marketing Expenses for sports team sponsorships. Accordingly, I have reflected this impact on Exhibit 7.1, Schedule 1, Column I. This adjustment increases the intrastate balance available for return by \$58,000.

Q. Do you agree with the proposed adjustment by Mr. Smith and Staff witness Hathhorn to remove \$ 9.253 million of intrastate operating expense for merger costs that SBC billed in 2000 ?

A. Yes. Although these costs are related to operations and therefore should not be booked below the line, I agree with Ms. Hathhorn, that these costs are more appropriately addressed in the Commission-mandated tracking of merger costs and savings. This adjustment increases the balance available for return by \$ 5.583 million and is included on Exhibit 7.1, Schedule 1, Column J.

Q. Do you accept the proposed intrastate adjustment by Mr. Smith of \$2.245 million to reflect interest during construction in the calculation of net operating income?

A. Yes, Ameritech Illinois agrees that the intrastate adjustment of \$2.245 million is appropriate.

This adjustment is shown on Exhibit 7.1, Schedule 1, Column K. This adjustment increases the intrastate balance available for return by \$1.354 million.

Q. Do you agree with the \$18.7 million adjustment made by both Staff witness Voss (Staff Ex. 5.0, Schedule 5.07) and Mr. Smith (GCI Exhibit 6-0, Sch. E-9) to uncollectible expense?

A. Yes, Ameritech Illinois accepts the \$18.7 million intrastate adjustment for uncollectible expense. This adjustment is reflected on Exhibit 7.1, Schedule 1, Column L., and increases the intrastate balance available for return by \$11.273 million.

Q. Do you agree with the proposed adjustment by Mr. Smith to increase the balance of materials and supplies as reflected on GCI Exhibit 6.1, Schedule E-12?

A. Yes, Ameritech Illinois agrees that the adjustment of \$1,242,000 to materials and supplies is appropriate. The amount proposed by Mr. Smith is representative of the current ongoing level of Materials and Supplies. This adjustment is shown on Exhibit 7.1, Schedule 2, Column B and increases the intrastate Net Original Cost by \$924,000.

Q. Please describe Schedule 1 of Ameritech Illinois Exhibit 7.1

A. Schedule 1 of Exhibit 7.1 is a revision of Schedule 1 of my Exhibit 7.0. Column A is equal to Column M of Exhibit 7.0. Column B contains the correction of my prior period

adjustment to income taxes. This information was furnished in the response to data request DLH-005 Supplement and was referenced by GCI witness Smith at page 48 of GCI Exhibit 6.0. Column B also reflects the impact of the adjustment to non-regulated expenses and the resulting effects of the allocation of income taxes to the intrastate jurisdiction. Exhibit 7.1, Schedule 3, supports this calculation.

Column C of Exhibit 7.1 represents the update for listing services that was inadvertently omitted. Column D represents the 1999 pension gains flowed through from Ameritech Services. Column E represents the adjustment to intrastate depreciation for accounts where the depreciation reserve levels had attained 100%. Column F represents tariff filings made by the Company since Exhibit 7.0 was filed. Both increases and decreases are reflected. The Company notes that this is a significant increase in rates, compared to Exhibit 7.0.

Column G is the adjusted intrastate operating results including known changes for calendar year 1999.

Column H is the adjustment for capitalized software proposed by Mr. Smith. While I accept this adjustment, I note that, when calculating this adjustment, Mr. Smith used the intrastate factor for Corporate Operations rather than the one for Plant Specific Operations. I used the correct factor in this column.

Column I reflects the adjustment for sports teams sponsorships proposed by Mr. Smith.

Column J adjusts the merger costs that will be addressed in the Commission mandated audit of merger costs and savings.

Column K reflects the interest during construction (AFUDC) offset proposed by Mr. Smith.

Column L is the Uncollectible expense adjustment proposed by Mr. Voss and Mr. Smith.

IV. ADJUSTMENTS WHICH THE COMPANY BELIEVES ARE NOT APPROPRIATE FOR REGULATORY FINANCIAL REPORTING

A. Interest Synchronization

Q. Mr. Voss and Mr. Smith have each made an adjustment to “synchronize” Ameritech Illinois’ interest expense for purposes of calculating 1999 income tax expense. Does this methodology accurately reflect Ameritech Illinois’ annual interest payments?

A. No, it does not. Interest synchronization is a theoretical concept which attempts to match the cost of debt component of the capital structure used in the calculation of the overall rate of return with the interest deduction used to compute income tax expense for ratemaking purposes. The interest synchronization methodology does not allow for fluctuation in the

interest rates, particularly the short-term interest rates on balances outstanding. In fact, interest synchronization looks at the cost of debt as of the end of a particular period, which will be different from the cost on any day in the past or the future. Thus, the fixed point in time chosen for the rate base and capital structure does not necessarily yield, through the method of interest synchronization, the true yearly interest payment needed to support that rate base.

Q. Mr. Dominak, are you including in your rebuttal testimony an interest synchronization adjustment?

A. No, I am not. The Company strongly disagrees with the concept and methodology of attempting to “estimate” interest expense when those costs are already available and truly represented by the actual expense amount incurred during the year under report here. While the Commission has historically adopted such adjustments in the context of rate cases, it is clearly inappropriate here where the Company’s actual earnings are being reported for purposes of evaluating the alternative regulatory plan. The effect of the proposed adjustment is to reflect interest payments the company never made in 1999. In this context, it is totally inappropriate.

B. Incentive Compensation

Q. At pages 4-6 of her testimony, Staff witness Everson proposes an adjustment to disallow management incentive compensation expense in the amount of \$24.062 million. Do you agree with Ms. Everson’s adjustment?

A. No. Incentive compensation plans are a standard part of employee compensation packages in most businesses and increasingly standard in government and even most for-profit organizations. Ameritech is no exception. As described in Ameritech's 1999 Proxy Statement, the practices of comparable large corporations consisting of a broad cross-section of approximately 65 major corporations in multiple industries are used in establishing the Company's incentive compensation. Incentive compensation is simply one component of the overall level of compensation necessary to attract and retain capable management employees. The Company's overall labor expense level (including management incentive compensation) represents a normal and prudent operating expense necessary to provide service. It is inconsistent with proper policy to not recognize costs associated with employee compensation in a discussion of the Company's financial performance. The expense was actually incurred by the company and to ignore it overstates the Company's financial performance. For Ms. Everson to sustain her adjustment, she would have to demonstrate that the Company would have achieved the level of performance that it did without such performance driven compensation. This she has not done.

Q. In support of her proposal, Ms. Everson (p. 5) argues that the Company's incentive compensation plan is "based on financial goals of return on assets and revenue growth" and that "inherent in these types of goals is a circular reasoning which clearly benefits shareholders, but not the ratepayers". Do you have any comments in response to Ms. Everson's argument?

A. Yes. In response to item 29 of the Company's First Set of Data Requests to Staff, Ms. Everson indicated that she "has no opinion on whether the circular reasoning argument

applies to a company subject to price cap regulation”. In fact, the “circular reasoning” argument does not logically apply to a price cap-regulated company, such as Ameritech Illinois. Ms. Everson’s argument is based on the premise that the “larger the increase in base rates granted, the greater the chances that Ameritech Illinois will meet the financial goals” and, therefore, the “larger the incentive compensation awards”. Under price cap regulation, however, the financial goals of return on assets and revenue growth are not achieved by requesting the Commission to grant “increases in base rates”. To the contrary, such goals are achieved primarily through improved efficiencies, cost control, growth in the number of sales and customers and development of new and improved products and services. Even in a rate-of-return setting, Ms. Everson’s logic fails. Incentive compensation contributes to the Company’s attainment of its financial targets and, therefore, benefits customers in that base rates in the next rate case would be lower than they otherwise would be.

Q. At pages 5-6 of her testimony, Ms. Everson discusses two cases in which the Commission did not recognize incentive compensation expense for rate making purposes. Do you have any comments in response to Ms. Everson’s discussion?

A. Yes. Neither of the two cases cited by Ms. Everson involve companies which are subject to price cap regulation. Moreover, the Commission has allowed the recovery of incentive compensation expense in a number of cases which are not cited by Ms. Everson including the two most recent proceedings involving a review of Ameritech Illinois’ revenue requirements, Docket 89-0033 and Docket 92-0448/93-0239. Other orders in which incentive compensation expense has been recognized include Northern Illinois Gas

Company, Docket 95-0219 (April 3, 1995); Illinois American Water Company, Docket 97-0102 (December 22, 1997);

Consumers Illinois Water Company (“CIWC”), Docket 97-0351 (June 19, 1998). In Docket 97-0351, for example, the Commission considered a Staff proposal to disallow incentive compensation expense under a plan in which incentive compensation is tied, in part, to CIWC’s parent company’s financial performance. Amendatory Order, Docket 97-0351, p. 15. A Staff witness in Docket 97-0351 argued, as Ms. Everson does in this case, that “the recovery of incentive compensation related to the corporate earnings goal relies on circular reasoning, i.e., the larger the rate increase granted, the more success CIWC will have in achieving its earnings goals and enhance its ability to award incentive compensation”. The Commission rejected Staff’s position, recognizing that incentive compensation tied to earnings provides employees with incentives to contain costs and maximize efficiencies, thereby benefiting customers. Amendatory Order, Docket 97-0351, pp. 16-17. The Commission allowed CIWC’s proposed allowance for incentive compensation expense in full.

As in the case of CIWC, Ameritech Illinois’ incentive compensation plan would benefit customers even if the Company’s non-competitive rates were subject to traditional rate-of-return regulation. As Ms. Everson acknowledged in response to item 31 of the Company’s First Set of Data Requests to Staff, a company can meet its financial performance goals of return assets and revenue growth through efficiencies, customer growth and/or new products. As Ms. Everson further recognized in response to item 30 of the Company’s First Set of

Data Requests, ratepayers benefit from revenue growth to the extent such revenue growth postpones a company's filing of a rate proceeding to increase rates. The same benefits accrue to ratepayers as a result of increased efficiencies and cost savings.

Q. Do you have any additional comments regarding Ms. Everson's proposed adjustment for incentive compensation?

A. Yes. Ms. Everson used total company amounts which were furnished in response to data request MHE-027. These amounts would need to be adjusted for interstate and non-regulated amounts, as well as capitalized amounts that are not charged to expense.

C. Social and Service Club Dues

Q. At page 6 of her testimony, Ms. Everson proposes an adjustment to eliminate Social and Service Club dues in the amount of \$280,044. Do you agree with Ms. Everson's proposal?

A. No I do not. Ms. Everson proposes to eliminate costs associated with memberships in all but one of the organizations listed in the response to data request SDR-038 on the grounds that participation in these groups is a "promotional and goodwill practice that is not necessary to provide utility service." Ms. Everson did not eliminate dues paid to the Rockford Area Chamber of Commerce. Of the \$280,044 which Ms. Everson proposed to adjust, however, \$29,500 is for dues paid to Chambers of Commerce throughout the Company's service territory. As the response to data request SDR-038 indicates, Chambers of Commerce promote business and development within the community. Promoting business and development makes for economically vibrant communities and increased demand for services including telephone service, thereby benefiting customers. The remaining portion of the amount eliminated by Ms. Everson includes dues paid to various business and industry organizations, primarily the Illinois Telecommunication Association. This organization provides education, concise information and a forum for its members to identify and examine issues of importance to the telecommunications industry such as 9-1-1 Emergency Services, labor relations and right-of way matters. All of these dues are normal and prudent costs of providing service and should be recognized for purposes of the Company's reported financials. These expenses have been recognized as appropriate in prior cases, involving

Ameritech Illinois including Dockets 89-0033 and 92-0448. As with other adjustments of the kind proposed by Ms. Everson, the effect is to overstate the Company's actual net income.

D. Sales and Advertising Expense

Q. At pages 7 to 8 of her testimony, Ms. Everson proposes an adjustment to reduce 1999 operating expenses by approximately \$95 million, an amount which she characterizes as "advertising expense". Do you have any comments on Ms. Everson's proposed adjustment?

A. Yes. As shown on Schedule 7.04 attached to her testimony, the amount which Ms. Everson proposes to disallow represents the total amount of expenses booked in 1999 to Account 6612, Sales Expense, and Account 6613, Product Advertising. Contrary to Ms. Everson's assumption, most of these costs are not "advertising" costs. Specifically, of the total adjustment of \$95.260 million, \$67.116 million represents expenses recorded in Account 6612, Sales Expense and \$28.144 million represent amounts booked to Account 6613, Product Advertising.

Q. What types of costs are recorded in Accounts 6612 and 6613?

A. The instructions contained in the Uniform Systems of Accounts Telephone Companies ("USOA"), for Account 6612 provides as follows:

This account shall include costs incurred in selling products and services. This includes determinations of individual customer needs, development and presentation

of customer proposals, sales order preparation and handling and preparation of sales records.

The USOA's instructions for Account 6613, Product Advertising provides as follows:

This account shall include costs incurred in developing and implementing promotional strategies to stimulate the purchase of products and services. This excludes nonproduct-related advertising, such as corporate image, stocks and bond issue and employment advertisements, which shall be included in the appropriate functional accounts.

The costs recorded by Ameritech Illinois in Accounts 6612 and 6613 during 1999 all meet the criteria set forth in the account instructions quoted above.

Q. In support of her proposal to disallow the amounts recorded in Accounts 6612 and 6613, Ms. Everson asserts that Section 9-225 (1)(e) of the Illinois Public Utilities Act and 83 Ill. Admin. Cod 295.10(a) prohibit the inclusion of operating expenses related to “promotional advertising” in determining a public utility’s revenue requirement. Do these provisions have any applicability to the expenses recorded in Accounts 6612 and 6613?

A. No. On their face, Section 9-225 and 83 Ill. Admin. Code Part 295 apply only in the case of a “general rate increase request by any gas or electric utility.” Ameritech Illinois is not a gas or electric utility and this case does not involve a general rate increase request. Furthermore, the expenses recorded in Account 6612 are not “advertising” expenses as the term is commonly understood and as it is defined in 83 Ill. Admin. Code 295.20(a). Section 295.20(a) defines “advertising” as follows:

ADVERTISING – THE TERM ADVERTISING MEANS THE COMMERCIAL USE, BY AN ELECTRIC OR GAS UTILITY, OF ANY MEDIA, INCLUDING NEWSPAPERS, PRINTED MATTER, RADIO

AND TELEVISION, IN ORDER TO TRANSMIT A MESSAGE TO A SUBSTANTIAL NUMBER OF MEMBERS OF THE PUBLIC OR TO SUCH UTILITY'S CUSTOMERS. In determining what constitutes a "substantial number," the Commission shall consider, among other things, the medium of communication used, the actual number of persons reached, and the size of the utility involved.

As previously discussed, the amounts recorded in Account 6612 are sales costs incurred to determine individual customer needs, development and presentation of customer proposals, sales order preparation and handling and preparation of sales records. These costs do not include "advertising" costs as defined above. The sales costs incurred during 1999 and recorded in Account 6612 are legitimate costs of doing business. Ms. Everson has identified no reason whatsoever for adjusting any portion of such costs in the presentation of 1999 financial data.

Q. Is there any basis for adjusting recovery of the product advertising expenses recorded in Account 6613?

A. Absolutely not. As previously discussed, the costs recorded in Account 6613 are costs incurred in developing and implementing promotional strategies to stimulate the purchase of specific services. Such costs clearly benefit customers by directly increasing units of sales over which fixed costs can be spread. In its Order in Docket 89-0033 (pages 69-70), the Commission accepted all of Ameritech Illinois' advertising expenditures, except for that apportioned from Ameritech headquarters. The Commission reasoned that product advertising expense (all included in Account 6613) is a normal and prudent business expenditure. In Docket 92-0448/93-0239, the Commission again recognized the benefits of

product advertising (pages 106-107), by allowing all of the test year costs recorded in Account 6613.

Q. Do the costs recorded in Account 6613 include any “promotional advertising costs” of the type which the Commission has not recognized as legitimate expense in previous cases involving Ameritech Illinois?

A. No. As discussed above, costs recorded in Account 6613 are product advertising costs of the type which the Commission has consistently recognized in cases involving Ameritech Illinois. In this regard, in Docket 92-0448/93-0239, the Commission made a distinction between product advertising of the type recorded in Account 6613, which was recognized in full, and “advertising to promote the Company’s corporate image and goodwill.” The Commission adopted a Staff and intervenor proposal to not recognize the latter category of costs for rate-making purposes, all of which were recorded in Account 6722, on the grounds that such advertising does “not directly increase the sale of any of [Ameritech Illinois] services.” None of the costs recorded in Accounts 6612 and 6613 during 1999 include “corporate image” and “goodwill” advertising expenses of the type which the Commission did not recognize in Docket 92-0448/93-0239.

Q. Ms. Everson asserts that this Company did not provide “evidence that the advertising was not promotional.” Is Ms. Everson’s assertion correct?

A. No. In response to Staff Data Request SDR-40, the Company provided Staff with a breakdown of “Demonstration and Selling, Advertising & Misc. Expenses” by the account in

which such costs were recorded: 6611, Product Management; 6612, Sales; 6613, Product Advertising ; and 6722, External Relations. The Company also provided copies of telemarketing scripts, all of which related to the marketing of specific services. A copy of the response to SDR-40, with an index of the telemarketing scripts provided to Staff is attached as Exhibit 7.1, Exhibit 4. In Data Request MHE-006, Staff requested that the Company provide detailed information regarding the amounts incurred with respect to costs of the scripts which had been provided in response to Staff Data Request SDR-040. In response, the Company indicated that the information requested is not identified, tracked or reported for either internal or external purposes in the form requested. The Company further indicated that all of the expenses associated with the marketing campaigns represented by the scripts has been recorded in one or more of Accounts 6611, 6612, and 6613. In Data Request MHE-007, the Company was asked to provide the same type of information requested in MHE-006 for “all types of advertising/solicitation campaigns”. The Company responded as follows:

The information requested by campaign is not identified, tracked, or reported for either internal or external purposes in the form requested. All advertising/solicitation costs expensed during 1999 were provided by Account in Schedule C-8 in response to SDR 040. Expenses included in Accounts 6611, 6612, and 6613 as shown in the response to SDR 040, are included in the amounts identified as Customer Operations Marketing on Schedule C-2. Expenses included in Accounts 6722 are included in the amounts identified as Corporate Operations on Schedule C-2. Additionally, the totals are not identifiable, tracked, or reported by type of media, e.g. radio, television.

Contrary to Ms. Everson’s assertion, the fact that the Company did not provide “detailed information on each advertising campaign expense for review” or track costs by type of

media does not logically support her proposal to adjust all of the sales costs recorded in Account 6612 and all of the product advertising costs recorded in Account 6613. The information provided to Staff (including the telemarketing scripts) shows that the costs recorded in those accounts relate to sales activities and advertising of specific services and do not include nonproduct corporate image advertising. Ms. Everson has presented no evidence to suggest that any of the advertising campaigns represented by the telemarketing scripts provided to Staff were improper or that they do not fall within the categories of sales and product-specific advertising for which costs are properly recorded in Accounts 6612 and 6613. The fact that the Company did not provide Staff with detailed cost breakdowns of the type requested in MHE-006 and MHE-007 does not logically support Ms. Everson's proposed adjustment.

Q. Ms. Everson notes that the Company was able to provide information regarding expenses specific to yellow page advertising. Do you have any comments concerning Ms. Everson's testimony in this regard?

A. Yes. The expense information requested by Staff regarding yellow pages advertising was readily available because this Company receives a distinct bill from the yellow pages publisher which identifies the full cost of the advertisements placed by Ameritech Illinois in the yellow page directories. Contrary to Ms. Everson's assertion, there is nothing inconsistent between Company's response regarding yellow pages and its response indicating that it does not separately track all expenses related to each individual product advertising campaign.

Q. Do you have any additional comments regarding Ms. Everson's testimony on advertising expense?

A. Yes. The Company believes that the information which it has previously provided to Staff is sufficient to support the 1999 level of advertising and sales expenses. Nonetheless, in response to Ms. Everson's testimony, the Company is providing the Staff with additional documentation regarding product advertising. Such additional documentation includes the total amount of advertising from Account 6613, Product Advertising that was spent in 1999 by product for residence and business services. This additional material should alleviate Ms. Everson's concerns.

Q. In his testimony (pp. 34-35), Mr. Smith proposes to adjust \$6.807 million of non-product "brand" advertising expense recorded in Account 6722. Do you have any comments regarding Mr. Smith's proposal?

A. Yes. Mr. Smith's proposal should be rejected. Non-product advertising that is recorded in Account 6722 benefits Ameritech Illinois because it highlights the many capabilities that Ameritech Illinois can provide to its most sophisticated customers. Advertising messages of how Ameritech companies such as Ameritech Illinois can solve complex communication challenges for customers acts as a reference for other companies with similar needs. Although the complex business applications may be sold under the "Ameritech" branded name it is Ameritech Illinois that collects the usage revenue generated by the sale of these products. Large businesses and institutions are the primary target of

many of the corporate campaigns. It is this market in which Ameritech Illinois has had the most competition for the longest period of time. Corporate advertising that showcases the Company's total capabilities is the best way to advertise in order to foster the idea with potential customers that Ameritech Illinois should be consulted whenever a business is considering a major purchase or attempting to solve a complex communications problem. It is this advertising that opens the door for Ameritech Illinois to successfully bid on communications solutions that generate revenue and retain traffic on the Ameritech Illinois network. As Ameritech Illinois and the other Ameritech Operating Companies face an increasingly complex and competitive marketplace, a unified identity is critical in differentiating them from other Bell companies and from companies such as AT&T and WorldCom. It is important that Ameritech Illinois customers understand and recognize the relationship of the company name that is derived from the corporate advertising.

E. External Relations Expense

Q. At page 9 of her testimony, Ms. Everson proposes to eliminate the 1999 level of expenses recorded in Account 6722, External Relations. Do you agree with Ms. Everson's proposal?

A. No. In support of her proposal, Ms. Everson asserts that External Relations expenses include "goodwill or institutional advertising" costs. In accordance with the USOA, however, the amounts recorded in Account 6722 include, in addition to the costs of non-product-related corporate image advertising, costs incurred in maintaining relations with

government, regulators, other companies and the general public. The activities covered by the account include (a) reviewing existing or pending legislation; (b) preparing and presenting information for regulatory purposes, including tariff and service cost filings; (c) administering relations, including negotiating contracts, with telecommunications companies and other utilities' businesses and industries; and (d) administering investor relations. All of these costs are reasonable and necessary costs of doing business as a regulated telecommunications carrier. There is no basis for not recognizing the recovery of such costs and such costs have consistently been recognized in prior cases. Of the \$20.413 million in intrastate external relations expenses, which Ms. Everson proposes to adjust, only \$7.610 million represent non-product "institutional" or "goodwill" advertising costs. For the reasons discussed above in response to the testimony of Mr. Smith, such costs should be recognized in the Company's financial performance for 1999.

Q. Do you have any additional comments regarding Ms. Everson's proposed adjustment for External Relations Costs?

A. Yes. A portion of the amount included in the External Relations expense which Ms. Everson proposes to adjust (\$52,000) represents Chamber of Commerce and other service club dues which is also included in the amounts reported to Staff in response to Staff Data Request SDR-038, which Ms. Everson used as the source for her proposed adjustment to eliminate social and service club fees. Accordingly, these amounts are double-counted in Ms. Everson's proposed adjustments.

F. Year 2000 Operating Revenues

Q. At page 15 of his testimony, Mr. Voss proposes an adjustment to increase the 1999 level of intrastate operating revenues by \$290,940,000. Is Mr. Voss' proposed adjustment appropriate?

A. No. Mr. Voss calculated his proposed adjustment by annualizing the increase in total intrastate revenues for the first nine months of 2000 over the total intrastate revenues for the first nine months of 1999. As a result of this adjustment, the operating income statement proposed by Mr. Voss in Schedule 5.01 of Staff Exhibit 5.00 reflects an annualized level of revenues for the year 2000 and a level of operating expenses incurred during the year 1999. Such an operating income statement cannot properly be the basis of the Company's 1999 financial performance. Mr. Voss purports to develop a revenue requirement on the basis of a 1999 financial performance using traditional rate case techniques. However, using those techniques requires that a revenue requirement be established by matching expenses, revenue and rate base for the same time period. By attempting to establish a revenue requirement on the basis of expenses and net original cost for 1999 and an annualized level of revenue received during the year 2000, Mr. Voss' analysis does not properly match expenses and net original cost of investment with the revenues which are supported by such expenses and investment. Accordingly, Mr. Voss' proposed revenue adjustment improperly reflects revenues in 1999 which the Company did not receive and therefore should not be included in evaluating the Company's 1999 performance.

Q. Has the Commission previously considered a revenue annualization adjustment of the nature proposed by Mr. Voss?

A. Yes. In Docket 92-0448/93-0239, certain intervenors proposed an adjustment to annualize business and residential revenues as of the end of the test year, utilizing four times the revenue levels recorded in the last three months of the test year. In the same case, Staff proposed an adjustment of Ameritech Illinois revenues to reflect the annualization of revenues for the last months of the test year . The Commission rejected both proposals, finding that they violated test year principles:

The Commission concludes that the Company's presentation of its revenues through the use of actual test year data, with an adjustment for known changes involving rate levels, is inherently more reasonable and less prone to measurement error than the annualization projection methodologies proposed by CUB/Cook and Staff. Furthermore, the Commission finds that the use of actual test year data for revenues comports with the intent of 83 Ill. Adm. code 285.150 to develop revenues and expenses for identical periods. The Commission therefore rejects CUB/Cook's and Staff's revenue annualization proposals and relies instead on the actual test period data presented by the Company.

In this case, Mr. Voss has gone even further than the Staff and Intervenors in Docket 92-0449/93-0239, by proposing to annualize revenues for a period entirely outside the year under report. Mr. Voss' proposed revenue annualization adjustment is, therefore, an even more blatant violation of test year principles and the Commission's own rules than the adjustments rejected in Docket 92-0448/93-0239.

Q. Has Mr. Voss cited any precedent to support his proposed revenue annualization adjustment?

A. No. In response to Item 18 of the Company's First Set of Data Requests to Staff, Mr. Voss stated that he is "aware of one Commission Order which supports his revenue increase adjustment". The Order cited by Mr. Voss is North Shore Gas Company, Docket 91-0010, in which, Mr. Voss claims, "the Commission increased revenues based upon increased customer growth." In fact, that case involved the use of a future test year. The Commission adopted forecasted levels of revenue and expenses for the future test year developed on the basis of projected increases in the number of residential customers. The Order in Docket 91-0010 does not in any way support Mr. Voss' proposal to mismatch revenues and expenses from two entirely different time periods.

Q. At page 15 of his testimony, Mr. Voss suggests that his revenue increase annualization adjustment proposal is justified by the fact that Ameritech Illinois "has adjusted its operating revenues for revenue decreases." Does Mr. Voss' suggestion have merit?

A. No. The Company's adjustment to 1999 operating revenues reflects the annualized effects of known and measurable changes (both increases and decreases) in the rate levels for various services as a result of the 1999 and 2000 price cap filings and other tariff filings during 1999 and 2000. The Company's adjustments do not reflect any changes in the level of 1999 sales and, therefore, do not reflect a change in the level of revenues associated with a change in the 1999 levels of expenses and investment. As a result, the level of revenues reflected in the Company's proposed operating income statement are properly matched with the 1999 operating expenses and investment.

Q. Mr. Dominak, what have you observed relative to the comparison of revenue for the first nine months of 1999 and 2000, as calculated by Mr. Voss?

A. A simple subtraction of the total revenues for the first nine months of 2000 compared to the first nine months of 1999 makes it appear that total company revenues before uncollectibles have increased in 2000 by \$235 million. This is the technique that Mr. Voss used. He then annualized this difference and applied an intrastate factor to arrive at an annualized revenue growth.

Q. Are there any reasons, in addition to those which you have already discussed, why Mr. Voss' approach is inappropriate?

A. Yes. Mr. Voss made no attempt to analyze the apparent change in the year over year increase. His underlying assumption is that revenues for nine months are representative of the entire year. Not only is this assumption incorrect, but it leads to false conclusions. For example, Basic Area Revenue appears to have increased by over \$100 million. A complete twelve month analysis however, would demonstrate that in fact there was almost no increase in local revenues since there were fourth quarter adjustments not reflected in Mr. Voss' analysis which render the revenue adjustment as proposed invalid. The remaining portion of the revenue increase calculated by Mr. Voss is primarily attributable to year-over- year increases in the number of customers and demand levels. Mr. Voss, however, makes no adjustments to reflect increases in expenses and investment associated with an increased number of customers and increased sales.

Q. Mr. Voss (p. 15) asserts that Ameritech Illinois' expenses have decreased in 2000 by more than 4%. Do you have any comments in response to Mr. Voss' assertion?

A. Yes. In response to a data request, Mr. Voss indicated that his calculation of the percentage reduction of expenses was based on comparison of expenses incurred on a total company basis during the first nine months of 1999 and first nine months of 2000. This calculated decrease, however, is almost entirely attributable to a pension settlement gain which was recorded as a credit to expense on Ameritech's books during the first nine months of 2000.

A comparable credit for pension settlement gains was recorded in December of 1999. By comparing the first nine months of each year, Mr. Voss' analysis fails to take into account the credit which occurred in December, 1999 and, therefore, this analysis is a case of comparing "apples to oranges". Eliminating the effect of the pension settlement gain recorded during the first nine months of 2000 shows that there was no reduction in the Company's operating expenses as compared to the comparable period during 1999.

Finally, Mr. Voss completely fails to take into account increases in the Company's investment in plant additions during 2000. From January, 2000 through November, 2000, this Company invested over \$788 million in plant additions to serve its Illinois customers. Mr. Voss' proposal to adjust operating revenues to reflect increased demand for services during 2000 without also adjusting the investment to reflect plant additions is inappropriate and violates the test year matching principle.

G. Gross Receipt Taxes

Q. Please discuss Mr. Voss' adjustment to revenues and expenses for gross receipt taxes.

A. Mr. Voss proposes an adjustment to remove both revenues and expenses for those gross receipts taxes that are included as revenues when received as add on charges from customers and included as expenses when remitted to the various governmental entities (Staff Exhibit 5.0, pages 16 – 18). He also proposes to disallow the 3% collection fee that

Ameritech Illinois is allowed to withhold for processing these payments. Mr. Voss' adjustment is wrong for several reasons. First, the revenues and expenses for gross receipt taxes virtually offset one another -- what comes in as a revenue goes out as an expense, minus the collection fee. Second, Mr. Voss applies an uncollectible factor to these receipts, thereby reducing allowable uncollectible expense in connection with his proposal to eliminate gross receipt taxes from revenues. This is incorrect. The Company remits to the governmental units the tax payments it receives, minus the collection fee. There is no uncollectible amount associated with the gross receipts revenues. Accordingly, it is inappropriate to make an adjustment to uncollectible expense in connection with an adjustment to gross receipts revenues.

Finally, the collection fee is not recorded as an expense. Accordingly, Mr. Voss proposes to disallow an expense which is not reflected in the Company's proposed operating income statement.

H. Service Quality Measures

Q. Please discuss Mr. Smith's adjustment to revenue to reflect the Company's failure to meet service quality standards.

A. At pages 36 to 37 of his direct testimony, Mr. Smith proposes an adjustment to increase 1999 revenues by one-half of the 1998 and 1999 annual amounts of revenue reductions which the Company was required to make in its annual price cap filing for not meeting one of

the eight service quality measures. The 1999 revenue reduction is attributable to failure to meet the service quality measure in 1998 and the 1998 revenue reduction is attributable to failure to meet the service quality measure in 1997. The Company satisfied all of the service quality measures in 1999.

Q. Is Mr. Smith's proposed adjustment appropriate?

A. No. Mr. Smith's adjustment imputes to Ameritech Illinois revenues it did not receive and, therefore, does not result in an accurate presentation of 1999 financial results. Furthermore, under the price cap formula, the revenue reduction required for failure to meet a service quality measure in a particular year continues to be reflected in rates on an ongoing basis. Thus, ratepayers have received the benefit of the annual reductions in revenues listed in Mr. Smith's Schedule E-8 in the year in which the revenue reduction was implemented and in each subsequent year. Mr. Smith's proposal to add back a full year of such revenue reduction to the 1999 level of revenues for purposes of calculating his proposed revenue requirement would have the effect of overstating the Company's revenues. If rates were reinitialized, customers would receive the same rate reduction again. Such double-counting is inappropriate.

I. Pension Settlement Gains

Q. At pages 6 through 8 of her testimony Staff witness Hathhorn discusses a proposed adjustment with respect to pension settlement gains. Do you have any comments with respect to Ms. Hathhorn's proposal?

A. Yes. In Ameritech Illinois Exhibit 7.0, Schedule 1, the Company included an adjustment to remove the impact of a \$98.6 million net pension settlement gain recorded in the books during 1999. The intrastate regulated portion of this gain is \$66.189 million. The effect of the Company's adjustment is to eliminate a credit to pension expense in the amount of \$66.189 million, thereby increasing 1999 operating expense by the same amount. Ms. Hathhorn proposes an adjustment to amortize over five years the amount by which the \$66.189 million intrastate pension gain exceeds what she claims to be a normal level of such gains. Ms. Everson's proposed adjustment is shown on Staff Exhibit 6.0, Schedule 6.03.

Q. Do you agree with Ms. Hathhorn's proposed adjustment?

A. No, I do not. The objective of Ameritech Illinois Exhibit 7.0, Schedule 1 is to present a normalized view of 1999 expenses. This is achieved by adjusting abnormal items that either have a distorted impact upon this view or were not incurred during the year under review. It is not appropriate to consider the pension settlement gains as a current period (1999) gain in this process. Furthermore, the gains were not caused in any way by the merger of SBC and Ameritech, as GCI witness Smith suggests. Rather, the gains represent an accelerated recognition of gains that occurred in prior periods, but were deferred in accordance with SFAS 87 accounting rules.

Q. Please describe the origin of pension settlement gains.

A. Pension actuarial gains and losses occur 1) when actual plan experience turns out different than what was assumed when developing annual expense levels; and 2) when actuarial assumptions are changed. For example, when developing annual pension expense, an assumption must be made about the investment return on pension fund assets. The expected investment return is a component of annual expense. If the fund is assumed to earn 8.5% per year and the actual return for the period is 15%, an actuarial gain has occurred. SFAS 87 allows these types of gains (or losses) to be deferred rather than immediately recognized. Other types of actuarial gains and losses are also deferred and carried forward to future periods. This reduces the volatility that would otherwise occur with immediate recognition.

When the pension plan makes lump sum pension payments to its participants, a settlement (or partial settlement) of the plan liability occurs. If the total lump sum pension payments exceed a certain threshold in a period, recognition of deferred actuarial gains/(losses) and the unamortized balance of any transition assets are accelerated. This accelerated recognition is what is referred to as a settlement gain or loss. Accordingly, settlement gains and losses recognized on the Ameritech Illinois books in 1999 are really just recognition of gains and losses that occurred in prior periods and, accordingly, should be removed in their entirety from the 1999 operating income statement developed for regulatory financial reporting purposes.

- Q. In support of her proposal, Ms. Hathhorn (pp. 7-8) argues that “ratepayers have previously funded 100% of the Company’s pension expense” and, therefore, that “ratepayers deserve full recovery of any gains reflected in the Company’s pension fund”. Do you agree with Ms. Hathhorn’s analysis?**
- A. No. In response to a data request, Ms. Hathhorn indicated that her assertion that “ratepayers have previously funded 100% of the Company’s pension expense” is based on the fact that, in Docket 92-0448/93-0239, “there was no adjustment to remove a portion of pension expense from the revenue requirement to cover the cost of such expense”. During at least the past nine years, however, Ameritech Illinois has recorded negative pension expense. Accordingly, there was no pension expense allowance reflected in the revenue requirement used to develop the rates established in Docket 92-0448/93-0239. To the contrary, the test year level of operating expenses for Docket 92-0448/93-0239 reflected a credit of \$37.7 million for negative pension expense. Accordingly, there would not have been any basis for an “adjustment to remove a portion of pension expense from the revenue requirement.”
- Furthermore, even if the revenue requirement established in Docket 92-0448/93-0239 did include a positive allowance for pension expense (and it did not), there would be no basis to conclude, as Ms. Hathhorn does, that ratepayers have previously funded 100% of the Company’s pension expense. As a result of the alternative regulation plan adopted in Docket 92-0448/93-0239, the rates charged by the Company for non-competitive service have been subject to a price cap formula, pursuant to which the overall level of rates declined each year without reference to a “revenue requirement”. Accordingly, there is absolutely no basis for the suggestion that ratepayers have been paying for pension expense since the

issuance of the Order in Docket 92-0448/93-0239. For these reasons, there is no basis for Ms. Hathhorn's assertion (p. 8) that ratepayers "deserve full recovery of the benefit of any gains reflected in the Company's pension fund."

Q. At page 30 of his testimony, Mr. Smith also proposes an adjustment for pension settlement gains to reflect a five year amortization of such gains. Do you have any comments in response to Mr. Smith's proposal?

A. Yes. Mr. Smith's proposed adjustment should be rejected for the reasons previously discussed above in response to Ms. Hathhorn.

Q. In footnote 6 at page 30 of his testimony, Mr. Smith suggests that the proposal to amortize the pension settlement gain over five years is consistent with the amortization of "workforce resizing expenses" in Docket 92-0448/93-0239. Do you agree?

A. No. The significant amount of retirements experienced by Ameritech Illinois that generated the 1999 settlement gains were not a result of a defined workforce-resizing plan. Those retirements were attributable to a number of factors, including the retirement eligibility of many of Ameritech's personnel and a robust job market for telecommunication personnel. Furthermore, the purpose of amortizing workforce resizing expenses is to reflect the fact that related costs savings are experienced over several years. That is not the case here.

J. Plant Under Construction

Q. Do you agree with the adjustments proposed by Staff and GCI related to Plant Under Construction?

B. No. At page 5 of her testimony, Ms. Hathhorn proposes use of a thirteen-month average of Plant Under Construction balances because the 12/31/99 balance was greater than any of the preceding twelve months. At page 44 of his testimony, Mr. Smith goes even further, using a 36-month average balance to arrive at his adjustment. He even includes eight months beyond the end of 1999 in computing his adjustment. These adjustments are inappropriate. An end of year investment was approved in Docket 92-0448 for all investment components, except for Material & Supplies. Staff and GCI have not identified a valid reason for changing that approach in this case. Ms. Hathhorn and Mr. Smith both assert that the 12/31/99 balance is unrepresentative of normal conditions. In fact, however, the January 31, 2000 balance was \$90M, more than \$10M higher than the 1999 end of year data. The February 29, 2000 balance was \$82M, also more than the end of year 1999. The 12/31/99 balance is representative of the ongoing level of plant under construction and should be used in the presentation of the Company's 1999 financial performance to be used in this review.

K. Asset Disposition Accruals

Q. At page 33 of his testimony, Mr. Smith proposes an adjustment with respect to asset disposition costs. Do you have any comments with respect to this adjustment?

A. Yes. Mr. Smith proposes an adjustment to reflect a five year amortization of asset disposition accrual in the amount of \$5.518 million. Mr. Smith asserts that estimated property accruals relating to the sale of land and buildings were too low. He further argues that costs have accrued over a number of years and, therefore, they should be ratably removed as indicated on GCI Schedule E-5.

Q. Do you agree with Mr. Smith's proposed adjustment?

A. No. Accruals were made for costs associated with the sale of several properties in 1994. Accruals by their very nature are estimates that can be higher and lower than the actual final costs. In this case, the accruals were higher than the actual costs, which reflects conservative accounting practice. Additionally, the original transactions occurred in 1994, a time when the alternative regulation was underway in Illinois. Therefore, rates were not impacted by the estimated accruals that were booked as the corporate expenses in 1994.

Having been satisfied that there are no more costs associated with these property sales, the Company made a reconciling adjustment in the amount of \$5.518 million as a credit to the

Corporate Operations expense in 1999 to remove the balance of the accrual. However, the transaction which gave rise to the accrual is clearly applicable to a prior period.

Accordingly, an adjustment to eliminate the credit was included in Ameritech Illinois Exhibit 7.0, Schedule 1, in order to achieve a proper expense normalization for this proceeding. Mr. Smith's adjustment has the effect of eliminating only one fifth of the credit in the calculation of his proposed revenue requirement. Mr. Smith's proposed adjustment would have the effect of giving credit for prior period accruals in 1999 results. There is no basis for this approach.

L. Depreciation Expense

Q. At page 30 of his testimony, Mr. Smith discusses an adjustment to reduce intrastate depreciation expense by \$386 million. Do you have any comments regarding this proposed adjustment?

A. Yes. Mr. Smith's adjustment is based on the testimony of GCI witness Dunkel, who argues that 1999 depreciation expense should be recalculated on the basis of depreciation accrual rates reflecting service lives, net values and curve shapes developed by the FCC for use in establishing depreciation expense for telecommunications carriers subject to traditional rate regulation. Mr. Dunkel's testimony on this subject is addressed by Mr. Gebhardt in his Rebuttal Testimony. For the reasons discussed by Mr. Gebhardt, Mr. Dunkel's proposal should be rejected and, therefore, the Commission should reject the adjustment to depreciation expense included by Mr. Smith in his proposed operating income statement. As I have previously discussed, however, the Company has made an adjustment to reduce 1999

intrastate depreciation expense by \$101.657 million to reflect elimination of depreciation on certain assets which were fully depreciated as of the beginning of 1999.

Q. Mr. Smith asserts that the related impacts of Mr. Dunkel's proposal with respect to depreciation expense on Accumulated Depreciation and Accumulated Deferred Income Taxes ("ADIT") are shown on Schedule E-2 of GCI Exhibit 6.0. Do you have any comments with respect to the adjustments shown on that schedule?

A. Yes. Schedule E-2 shows Mr. Smith's calculations of adjustments to reduce the 1999 year-end Accumulated Depreciation Reserve by \$385,739,000 equal to the proposed reduction in annual depreciation expense. For the reasons discussed by Mr. Gebhardt, however, if the Commission were to adopt Mr. Dunkel's proposal with respect to depreciation expense, it would be necessary to adjust the accumulated depreciation reserve to reflect the amounts which would have been accrued on the basis of Mr. Dunkel's proposed depreciation rates since 1994. Thus, if the Commission were to adopt GCI's proposed adjustment to depreciation expense (and it should not), the 12/31/99 intrastate depreciation reserve balance should be reduced by \$1,708,302,000 and the associated adjustment to the deferred income tax balance is \$677,632,000.

M. FAS 71 AMORTIZATION

Q. At pages 18 to 19 of her testimony, Staff witness Marshall proposes an adjustment to remove the amortization of the FAS 71 adjustment from the Company's 1999 operating income statement. Should Ms. Marshall's proposed adjustment be adopted?

A. No. As discussed in Mr. Gebhardt's Direct Testimony, the amortization referred to by Ms. Marshall results from the discontinuance in 1994 of the application of FAS 71, which resulted in the writing up of the Company's depreciation reserve or, equivalently, writing down the net value of its assets for financial reporting purposes. As Mr. Gebhardt explains in his Rebuttal Testimony, the write-down represents the financial accounting equivalent of a reserve deficiency, which is properly amortized over a reasonable period of time, in this case eight years.

Q. In support of her adjustment, Ms. Marshall asserts that the FAS 71 write-off includes \$80 million made up of several items for which the Commission has previously prescribed regulatory treatment or denied recovery from ratepayers. Is Ms. Marshall correct?

A. No. The expenses described at page 20, line 433 through page 21, line 446 of Ms. Marshall's testimony were not, contrary to her assumption, included in the amount being amortized over eight years and reflected in the Company's 1999 expense levels. Instead, those amounts were recognized on the Company's books as a one-time adjustment in 1994. The FAS 71 adjustment at issue in this case consists entirely of the eight-year amortization of the depreciation reserve deficiency. This can be seen by multiplying the total FAS 71 annual amortization amount of \$143,875,000, as shown on Staff Exhibit 4.0, Attachment 4.01, by eight years. The resulting amount is \$1,151 million which, as indicated on Staff Exhibit 4.0, Attachment 4.03, page 2, is the amount of the increase to the accumulated depreciation reserve and does not include elimination of the other net regulatory assets of approximately \$80 million.

Q. Ms. Marshall (p. 21) suggests that the FAS 71 adjustment includes cost for which the amortization period expired prior to 1999. Is this correct?

A. No. As stated above, the eight year amortization began in 1994 and, therefore, does not expire until 2002. Contrary to Ms. Marshall's suggestion at page 20, the amount being amortized in 1999 does not include any portion of the depreciation reserve deficiency for which the Commission prescribed a five year amortization period in Docket 92-0448.

Q. Do you have any additional comments regarding Ms. Marshall's proposed FAS 71 adjustment?

A. Yes. For all the reasons discussed above and in Mr. Gebhardt's testimony, Ms. Marshall's proposed adjustment to operating expenses should be rejected. In the event that the Commission adopts Ms. Marshall's proposed adjustment, however, it is necessary to adopt the corresponding adjustment to depreciation reserve proposed by Staff witness Voss in his Schedule 4.01. This adjustment is addressed by Mr. Gebhardt.

N. **Directory Revenue**

Q. Beginning at page 20 of his testimony, Mr. Smith proposes an adjustment of \$163 million to Directory Revenue. Do you agree with this adjustment?

B. No, for reasons discussed by both Mr. Barry and Mr. Gebhardt in their Rebuttal Testimony, this proposed adjustment should be rejected.

Q. At pages 27 – 28 of his testimony, Mr. Smith discusses Table B-10 of FCC Report 43-02 in connection with Yellow Pages and Directory operations for 1999. Do you have any comments regarding this?

A. Yes, Mr. Smith discusses the gross debits and credits associated with activity for Ameritech Publishing Inc. and Don Tech on lines 102 and 118 of Table B-10 on FCC Report 43-02, and draws a conclusion that the gross debits represent payments to API and Don Tech in the amount of \$1.01 billion.

Q. Is this a correct interpretation of the data contained in Table B-10?

A. No.

Q. Please explain Table B-10 filed in FCC Report 43-02.

A. Contrary to the use made by Mr. Smith, Table B-10 does not provide a record of actual payments made by Ameritech Illinois to API or Don Tech. As it is labeled, Schedule B-10

is a representation of Ameritech Illinois' accounts payable account to affiliates for calendar year 1999.

Each affiliate that conducts services with Illinois Bell is listed in column (b). Column (c) records the beginning balance – the amount shown on the general ledger as payable to the affiliate at the beginning of the year. Column (d) records gross debits – the total amount of journal entry debits made to the account due to payments to the affiliate or for other reasons such as corrections for posting errors, or transfers to other accounts due to mechanical billing limitations. Column (e) records gross credits – the total amount of journal entry credits made to the account due to additions for new amounts owed to the affiliate added during the year or for other reasons such as corrections for posting errors, or transfers to other accounts due to mechanical billing limitations. Column (f) records the ending balance - the amount shown on the general ledger as payable to the affiliate at the end of the year.

Q. Does Table B-10 in FCC Report 43-02 provide a record of actual payments made by Ameritech Illinois to an affiliate for calendar year 1999?

A. No, Table B-10 by itself does not provide a record of actual payments by Ameritech Illinois to any affiliate for calendar year 1999 for several reasons. First, the schedule reflects journal entries made during 1999, but those entries may not relate to 1999 activity only. For example, the total shown in Row 102 in the gross debit column for Ameritech Publishing (\$513.7 million) includes only \$321.2 million paid to Ameritech Publishing during 1999.

However, the amount shown does not include an additional \$27 million collected for Ameritech Publishing in December, 1999, which was not paid and, therefore, journalized until January 2000.

Second, because of the way the Ameritech Illinois books are maintained, amounts ultimately payable to Ameritech Publishing are initially credited to the Don Tech accounts payable account from the mechanized billing system. The amounts are then manually debited out from the Don Tech accounts payable account and credited to the Ameritech Publishing accounts payable account. Because of this method of accounting, the amounts actually paid to Ameritech Publishing appear to be recorded twice, once in the accounts payable to Don Tech and again in the accounts payable to Ameritech Publishing. The amounts, however, are actually paid only once to Ameritech Publishing exclusively.

Third, Table B-10 includes the effects of journal entries posted to the accounts in error. That is, amounts were credited or debited to the accounts in error and were subsequently reversed out of the account to correct the errors. This activity is reflected in the gross totals of debits and credits shown in Table B-10 even though they offset each other and no payment was owed or made with respect to these entries.

Q. Mr. Dominak, in your opinion can Table B-10 in FCC Report 43-02 be used as a reliable source of affiliated payments and billing collection?

B. No it cannot. As stated above, what Mr. Smith is perceiving as a balance owed is simply offsetting debit and credit journal entries. The debit amount for Don Tech is offset by a credit owed API. For this and the other reasons I have identified, the Table B-10 does not reflect amounts collected and remitted to API for Yellow Pages advertising.

Q. What was the amount billed and paid to API for Yellow Pages advertising by Ameritech Illinois for 1999?

A. The actual amount billed for API Yellow pages advertising by Ameritech Illinois for 1999 was \$391 million. Of this amount, \$348 million was ultimately remitted to API and \$43 million was retained for uncollectibles.

Q. Staff witness Everson also proposes a Directory Revenue adjustment of \$126 million. Do you have any comments on this proposed adjustment?

A. Yes, this proposed adjustment should also be rejected for reasons addressed in the Rebuttal Testimony by Mr. Gebhardt and Mr. Barry.

Q. Mr. Dominak, did you compute an overall rate of return on net original cost of property based upon the adjustments made in Exhibit 7.1, Schedule 2?

A. Yes, I did. The revisions reflected on Exhibit 7.1, Schedule 2 change the overall return for 1999 from 16.65% to 19.13%

Q. Mr. Dominak, does this conclude your rebuttal testimony?

A. Yes, it does.

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